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**Directorate for Financial, Fiscal and Enterprise Affairs  
Centre on Tax Policy and Administration**

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**Fiscal Design Across Levels of Government  
Year 2000 Surveys**

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**Country Report: Czech Republic**

**FINAL**

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## GENERAL INTRODUCTION TO THE SURVEY

In accordance with decisions made by the "Fiscal Decentralisation Initiative for Central and Eastern Europe" (FDI), the OECD has initiated surveys on fiscal decentralisation for the purpose of providing international comparisons on the design of fiscal systems across levels of government.

FDI is a joint initiative of the OECD, the World Bank, the Council of Europe, the Open Society Institute, UNDP, USAID and OECD Member countries to assist transition economies in Central and Eastern Europe in carrying out intergovernmental reforms. The main objectives of the Initiative are: to encourage local democracies to improve the capacity of local governments to plan and administer expenditures and raise revenues; and to support local governments in their efforts to become more responsive and accountable to their constituencies.

Thereby the survey has been written in response to a questionnaire designed by the OECD and follows the structure outlined in the questionnaire.

The survey specifically indicates the state of the following fiscal decentralisation issues:

- The design of fiscal systems.
- The profile of sub-national revenues.
- The profile of sub-national expenditures.
- The match between locally-managed expenditures and the corresponding revenues.
- The institutional arrangements for ensuring fiscal discipline and budgetary constraints.
- The design of intergovernmental fiscal relations.

The surveys in 2000 took place in six countries in Central and Eastern Europe: three OECD Member countries - the Czech Republic, Hungary and Poland - and the three Baltic states - Estonia, Latvia and Lithuania.

The survey was carried out between April 2000 and January 2001.

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## **1. EXECUTIVE SUMMARY**

### **1.1 Main features of local finance and the inter-governmental relation**

The Czech Republic has a unitary status. Up until 2001 there were only two tiers of government - central government and local government at municipal level. Local government covers more than 6 000 municipalities. The autonomy of local government is granted by the Constitution and the Act on Municipalities.

The local government budget is separated from the Central government budget. The only link is given by the grant system. All municipalities regardless their size enjoy the same rights and obligations. Each municipality represents a legal entity. Its responsibilities are divided between own and delegated ones. The own responsibilities include among other tasks in education, welfare services, housing, health care, culture, public safety, street cleaning, water, electricity and gas supplies, sewerage system. Among delegated responsibilities can be found: birth, death and marriage registers and building permissions. Different tasks in environmental protection, sanitation, statistics and so on belong also to this group.

The basic reform of local government system took place in 1993 together with the overall tax reform. Since that the local finance system underwent several minor changes. The radical change took place only in 2001 together with regional government installation.

The most important source of local budgets is tax revenue. There are no local taxes, only local fees at present. Municipalities participate on personal income tax and corporate income tax. They also receive the total yield of real property tax collected within their territory. As concerns the tax on buildings, the base is given in the form of physical parameters, the usage plays also a certain role.

The income tax sharing was up to 2000 including as follows. Municipalities were granted 20 % of the total yield of corporate income tax. The municipal share was distributed on the base of population of each municipality. The personal income tax has three parts in the Czech Republic. First, it is the wage tax, which was distributed among municipalities according the district collection. Municipality, in which employers' office was registered, received 10 % of the collected amount, 20 % was distributed according the number of citizens in each municipality within a given district, and the rest was assigned to the central government. The unincorporated income tax yield was allocated to the municipality, in which the particular entrepreneur had his permanent home address.

This above described system led to growing disparities among municipalities of different size and location. It was seen injustice as any municipality could influence this revenue only very little. It also led to a special competition among municipalities concerning the location of employers' registered office and permanent home addresses of entrepreneurs. It was a competition, which had nothing to do with building up a bigger tax base. Moreover, some additional cost was involved, which then lowered the tax revenue for municipal sector.

The change applicable since 2001, however, did not solve the problem of a rather small municipal discretion over their revenue. A certain room for own decision of local government is provided only by local fees. In this case local government also administers this revenue source. The law sets the list

of local fees and their upper limits. Some of local fees are planned to be transmitted into local taxes. The fee on operated gambling machines, on recreational units and the fee on use of public space are examples of local fees.

The system of central government grant consists of mainly operating subsidies, which are decided each year when preparing the central budget. They do not take into account the revenue level of any municipality as they are calculated as a certain amount per pupil in pre-school facilities and primary schools, per bed in social care facilities, as a contribution to the tasks of state administration provided by local government and so on. Capital grants are as well decided when preparing the central budget on ad hoc base. Once started projects have the priority.

All grants transferred to local government are specific grants in the sense that their provision does not allow local government to allocate them according their discretion. The precise use of grants is defined by the central government. In case that a municipality does not succeed to spend the grant amount in the given year and for the given purpose, it must return this amount back. All municipalities, which received a grant, must make an annual statement for these grants.

## **1.2 Major empirical findings**

Table 2.2 Municipalities by size (December 31, 1999).

Table 3.2 Classification of taxes of sub-central governments. Local Government, 1997-1999 (in millions of CZK).

Table 3.4 The profile of central grants to local governments, 1997, 1998 and 1999, in millions of CZK.

Table 4.1 Expenditure assignment - actual status of the legal framework.

## **1.3 Main problems in the fiscal design**

Some problem of the tax sharing system valid up to 2000 were already removed by the change in 2001. At present there is a necessity to change the tax sharing system in the way, which would enable to introduce a link between the municipality effort and its tax revenue.

Generally, all taxes in the Czech Republic are decided by the central government fixed in legislation, central government also collects and administers all taxes. Local government in the Czech Republic has only very limited tax authority. At present, the local government control over tax rates, tax bases and collection is not significant – less than 3 % of total municipal tax revenue could be called as actually own taxes of local government. Municipalities have a certain room when deciding rates of real property tax and local fees rates (with restricted discretion over fee base).

Local taxes installation is almost an evergreen in the policy debate on local finances in the Czech Republic. The apparent fear that local government would radically increase the tax burden is still too strong to introduce local taxation or anyhow increase the influence of a municipality over its revenue. Nowadays local government has only very limited power to decide its revenue. That makes them too dependent on sharing taxes and grants and receipts from sale of their property.

Relatively low yield of the property tax and its decreasing share on the total local government revenue are other issue to be solved soon. The new property tax should be based on market prices and give municipalities more discretion over this revenue. Also numeral exceptions, which exist at present, should be reduced.

The whole system of regional government finances is under consideration only. At present regional elected representatives often complain that they have almost no way how to get funds to manage their office and tasks properly. To prepare a new schedule might be very difficult due to the fact, that

particular regions will be given different facilities and therefore have different needs of funding. This complicate the introduction of the unified system of their financing.

What to do with district office is another task to be solved. At present they provide a wide range of state administration tasks as well as many services, which do also municipalities. In many cases these functions were left to them because of the very small size of prevailing municipalities. The present consideration includes that district offices should be abolished by year 2002. Yet, there is no mechanism, how to transfer some of their functions to the regional level of government.

#### **1.4 The status of policy reform consideration**

The overall public sector reform is just proceeding. It has several tasks. First of all it is the establishment of regional self-government. First regional election took place in November 2000 and this way the local councils for 13 regions were elected. Prague, which is a municipality as well as region, will held first election together with municipal election in 2002. Financial terms and responsibilities will be provisional for first two years of their existence. In this period they will be under close control of the central government and will be financed mainly through central government specific grants. Their present responsibilities, as given in a special law, include among others regional development, environmental protection, some roads, regional transport, secondary education, social care facilities, museums, and big libraries. Particular facilities needed for carrying out these tasks will be transferred during this year.

In the year 2001 a new system of tax sharing was established. The sense of this change was to bring more justice into the system. The underlying condition was not to change the relation of the proportion of central budget and local budgets tax revenue. Into the sharing system now belong not only income taxes, both personal as well as corporate ones, but also value added tax. Within the personal tax not only wage tax is shared, but also the unincorporated income tax. All shared taxes are allocated among municipalities on the base of the total yield collected and according the number of citizens of each municipality. There are some coefficients involved that make the sharing more favourable for bigger municipalities (new sharing rules could affect the amalgamation process, but in January 2001 the number of municipalities increred by seven). The further improvement of this sharing principle is still under consideration. It should connect in a better way the effort of a municipality with its tax revenue.

The public sector reform follows following tasks:

- improvement of the overall efficiency of public sector;
- stress on transparency of funds spent and on the stability of the finance system;
- increase of the control mechanism;
- introduction of medium term financial planning, and
- local taxes installation.

As the main tool of the improvement of the overall efficiency of public sector is considered further transfer of functions from the central government to lower tiers of the government. Standards of the accessibility and quality of public services are being worked out and are supposed to improve the public services provision. Similar role is seen in building up an unified information system for the whole public sector and in using modern management methods, tools, and forms.

The transparency should be improved by the existence of clear rules and responsibilities split within the general government, by clear definition of the government sector towards private one, by

availability of reliable and understandable set of information, and by including all necessary items into the relevant budget. The unified government account will be established, which enable the integration of all public information systems and the link among expenditure and cash management. This single government account should also bring some savings as far as the borrowing cost is concerned.

The establishment of the State Treasury is under preparation. It will monitor and check public funds operations also (at lower levels of government and in case of extra-budgetary funds will check the flows from the central budget), provide public debt management, management of EU funds, and prepare medium term financial outlook

The new budgetary law adopted in 2000 introduced besides ex post control also ex ante control and the division of management and control functions.

Medium term planning should include not only expected revenue and expenditure items in needed composition for a given period of time, but also the assessment of impacts of today's decisions for future revenue and expenditure.

Local tax installation should increase the local government discretion over its revenue. It is also supposed to introduced more accountability into the local government spending.



## **2. THE TECHNICAL FRAMEWORK – CLASSIFICATION OF LEVELS OF GOVERNMENT AND ECONOMIC TRANSACTIONS**

The Czech Republic has a unitary status and there are two tiers of government at present: Central government and local (municipal) government. However, before 2001, public finance (general government) was divided into five segments: state budget, district office budgets, health security, segregated state funds and local budgets. Throughout this contribution to the survey, we will deal with the central budget (including district offices budgets) and local budgets.

The division between central and local budgets is influenced by historical factors. Since the renewal of the self-government principle, in 1990, all changes have been made on the principle that each task should be allocated to the level of government which can best implement it, i.e. at the level that has most information and is able to perform the task effectively, as close to the citizens concerned as possible.

The autonomy of local government is assured by the Constitution and the Act on Municipalities.

The budget of each segment of public finance is presented on an annual basis. With the exception of local budgets and district office budgets, all others are approved by Parliament. In relation to the two exceptions, the Parliament approves only the grants to them. The budgetary year corresponds to the calendar one. The budget of both parts of the general government must contain every revenue and expenditure item, and reflect each financial operation. The budgetary structure required for the uniform reporting is obligatory for all parts of the general government budget.

The Czech economy during the period 1997-1999 can be illustrated by the development of GDP:

**Table 2.1** Gross Domestic Product, 1997-99. Market prices (in millions of CZK)

	<b>GDP</b>
1997	1,668,800
1998	1,798,300
1999	1,836,300

*Source:* The Czech Statistical Office, April 2000

Over the same period, general government expenditure has grown from 41.8 per cent of GDP in 1997, to 43.1 per cent in 1999.

### **2.1 Central Government**

#### **2.1.1 State Budget**

The state budget covers all central government finances, except the health insurance system. The state budget is divided into chapters covering budgets of particular ministries, the President's office, Parliament, and other central government bodies, including district offices. The chapters reflect the independence of central government bodies from the point of view of budgetary planning,

implementation and accounting. Parliament approves the state budget act, each year. When there is a change in tax sharing between the state and local government budgets, it is dealt with in a separate law. Part of the grants to particular municipalities is also included in the state budget act. The state budget act includes, for the time being only, the data for the following year. A very brief medium-term fiscal outlook is included, too (from 2000, a regular medium-term fiscal outlook is submitted to the Parliament).

### **2.1.2 State Funds**

State funds are bodies responsible for certain central government functions. They may be partly financed outside the central budget. Each fund is established by a specific law defining its purpose, source of revenue, possible range of expenditure and the ministries responsible. These funds are set to fill specific public objectives. At present, there are the following funds in the Czech Republic: the National Property Fund, the State Environmental Fund, the State Fund for Market Regulation in Agriculture, the State Fund for Soil Fertilising, the State Fund for Culture, and the State Fund for Support and Development of Czech Cinematography.

### **2.1.3 Health Insurance System**

This system consists of the General Health Insurance Company, established by a specific law, and nine Employee Health Insurance Companies, which received their licenses from the Ministry of Health. The main source of revenue for the health insurance system are the contributions paid by employers, employees, the self-employed and the state. These contributions are defined as a percentage of income. The law sets the rate for these contributions. The state pays these contributions on behalf of defined groups of citizens such as children, women on maternity leave, the unemployed, soldiers, pensioners, etc. Its contributions are derived from the minimum wage level. Parliament approves the budgets of all Health Insurance Companies. These companies are responsible for financing health care.

### **2.1.4 District Offices**

The territory of the Czech Republic is divided into 77 districts. District offices form an intermediate level between central government and the municipalities. These offices act as intermediaries, performing state administration, without self-government functions. The employees of district administrations are officials of the central government, appointed by the central government and falling under the responsibility of the Ministry of Interior. The four biggest cities – Praha, Brno, Ostrava and Plzeň – perform functions assigned not only to municipalities but also to district offices. These cities constitute districts in themselves. Generally, assemblies of municipal representatives in a given district determine some of the district's revenue distribution functions. The hybrid status of district administrations is viewed as unsatisfactory and districts have been transformed into an ordinary part of central government (one of the state budgetary chapters) since 1<sup>st</sup> January, 2001. For the purposes of the *IMF Government Finance Statistics* and the *OECD Revenue Statistics*, districts were combined with the municipalities as local government. For the purpose of this survey, districts are treated as a part of central government, only municipalities are treated as a self-organising local level of government.

Public transport and all other expenditure (including transfers to municipalities) are either granted by central government or covered by receipts from shared personal income tax on wages and salaries. The shared revenue for each of the 73 standard district offices consists of 30 per cent of tax proceeds collected in the district area. Municipalities on these areas do not finance the district functions. The remaining four largest cities receive 40 per cent of tax proceeds for "district" purposes (together with the general 30 per cent to which all municipalities are entitled).

## 2.2 Local Governments

The local government sector is separated from the central budget. The only link is the grant system. There is only one level of local government – municipalities. All municipalities, regardless of their size, have the same rights and obligations. The year-end budget (accounts) of a local government must be audited by an auditor or by a related district office.

In 1999, there were 6,239 municipalities in the Czech Republic. The number of them grew at the beginning of nineties, immediately after the law enabled even a tiny part of a municipality to separate. This development was mainly the consequence of forced amalgamation put into effect in the Sixties. Following that amalgamation, many small villages did not get many central government resources for their development and they suffered an outflow of their citizens. The number of municipalities grew by 50 per cent between 1990 – 1992. The resulting size structure of municipalities is given in Table 2.2.

**Table 2.2** Municipalities by size (December 31, 1999)

Number of inhabitants	Number of municipalities	Proportion of municipalities (%)	Proportion of the whole population in municipalities within the population range (%)
= 999	4,963	79.55	16.76
1 000 – 1 999	654	10.48	8.80
2 000 – 4 999	357	5.72	10.67
5 000 – 9 999	134	2.15	9.05
10 000 – 49 999	109	1.75	21.54
50 000 – 99 999	17	0.27	12.14
>100 000	5	0.08	21.04

*Source:* Ministry of Finance of the Czech Republic

Table 2.2 shows that 90 per cent of municipalities have less than 2 000 citizens. More than half of the inhabitants live in big cities of over 10 000 citizens. The size structure of municipalities is therefore fragmented: small and very small municipalities prevail. However, the role and tasks of municipalities are defined by the law, regardless of their size.

From 2001, a new level of the local government has become effective. For more details on 14 regions, see Chapter 4.1.

### **3. GOVERNMENT FINANCE STATISTICS ON SUB-NATIONAL GOVERNMENTS**

#### **3.1 Sub-national Revenue**

Table 3.1 shows a detailed breakdown of revenue by level of government. Overall, the most important revenue source is tax revenue. Grants represent a complementary source only.

The tax revenue data (heading 2000) for central government are not consolidated, i.e. contributions paid by government are in the gross form in accordance with the OECD Revenue Statistics. It implies negative grants in the Table. The central government budget consists of the state budget and state funds (State Environmental Fund etc.). As far as the social security fund is concerned, the accounting system used by health insurance companies was changed, in 1999 (the transition from accrual to cash affected the government finance statistics). Social security funds cover the health insurance system only.

##### **3.1.1 Tax revenue**

According to the OECD classification, local government taxes are subdivided into categories of decreasing tax autonomy and control over the tax revenue, i.e.

- (a) municipality sets tax rate and tax base
- (b) municipality sets tax rate only
- (c) municipality sets tax base only
- (d.1) municipality determines revenue-split
- (d.2) revenue-split can only be changed with consent of municipality
- (d.3) revenue-split fixed in legislation, may unilaterally be changed by central government
- (d.4) revenue-split determined annually by central government as part of the budget
- (e) central government sets tax rate and tax base.

**Table 3.1** Total revenue by level of government, 1997, 1998, 1999, in millions of CZK

	Central Government			Social Security Funds			Regional Government			Local Government			General Government (Consolidated)		
	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
<b>Tax Revenue</b>															
1000 Taxes on income, profits & capital gains	85848	98681	97689							57417	63734	67634	140374	158128	160133
2000 Social security contributions	190155	203334	210311	94572	104479	112667							246755	264401	270623
3000 Taxes on payroll and workforce	172	59	92										172	59	92
4000 Taxes on property	4954	6250	6824							3943	4108	4248	8897	10358	11072
5000 Taxes on goods and services	207191	212287	236476							4040	4172	3691	211231	216386	239869
6000 Other taxes	206	123	147							98	86	106	304	209	253
<b>Total Tax Revenue</b>	<b>488526</b>	<b>520734</b>	<b>551539</b>	<b>94572</b>	<b>104479</b>	<b>112667</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>65498</b>	<b>72100</b>	<b>75679</b>	<b>607733</b>	<b>649541</b>	<b>682042</b>
<b>Non-tax revenue</b>															
Oper. surpl. of dept. enterpr. & prop. Income	10214	9619	6458	273	281	242				5560	7140	7362	16047	17040	14062
Fees, sales, fines	8056	6945	8725	42	39	-391				14680	16066	17339	22759	22978	27424
Contr. to govt. employee pension funds															
Other Non-tax revenue	4125	4318	3727	396	761	570				11291	11523	32850	15513	16388	37147
<b>Total Non-Tax Revenue</b>	<b>12181</b>	<b>11263</b>	<b>12452</b>	<b>711</b>	<b>1081</b>	<b>421</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>31531</b>	<b>34729</b>	<b>57551</b>	<b>54319</b>	<b>56406</b>	<b>78633</b>
<b>Grants</b>	<b>-10028</b>	<b>-10893</b>	<b>-12145</b>	<b>385</b>	<b>473</b>	<b>-47</b>				<b>22321</b>	<b>22738</b>	<b>25310</b>	<b>78</b>	<b>45</b>	<b>277</b>
<b>Total Revenue</b>	<b>490679</b>	<b>521104</b>	<b>551846</b>	<b>95668</b>	<b>106033</b>	<b>113041</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>119350</b>	<b>129567</b>	<b>158540</b>	<b>662130</b>	<b>705992</b>	<b>760952</b>
<b>Tax tax revenue as % of GDP</b>	<b>29,27%</b>	<b>28,96%</b>	<b>30,04%</b>	<b>5,67%</b>	<b>5,81%</b>	<b>6,14%</b>	<b>0,00%</b>	<b>0,00%</b>	<b>0,00%</b>	<b>3,92%</b>	<b>4,01%</b>	<b>4,12%</b>	<b>36,42%</b>	<b>36,12%</b>	<b>37,14%</b>
<b>Sub-national tax revenue as % of total tax revenue</b>							<b>0,00%</b>	<b>0,00%</b>	<b>0,00%</b>	<b>10,78%</b>	<b>11,10%</b>	<b>11,10%</b>	<b>100,00%</b>	<b>100,00%</b>	<b>100,00%</b>

Sources: Ministry of Finance of the Czech Republic; The OECD Revenue Statistics 1965-1999

**Table 3.2** Classification of taxes of sub-central governments. Local Government, 1997-1999 (in millions of CZK)

	<b>1997</b>								
<b>Category</b>	<b>a</b>	<b>b</b>	<b>c</b>	<b>d.1</b>	<b>d.2</b>	<b>d.3</b>	<b>d.4</b>	<b>e</b>	<b>Total a-e</b>
1000 Taxes on income, profits & capital gains						57417			57417
2000 Social security contributions									
3000 Taxes on payroll and workforce									
4000 Taxes on property		3943							3943
5000 Taxes on goods and services	1317					2723			4040
6000 Other taxes	98								98
<b>Total</b>	1415	3943	0	0	0	60140	0	0	65498
(% distribution)	2,16%	6,02%	0,00%	0,00%	0,00%	91,82%	0,00%	0,00%	100,00%
	<b>1998</b>								
<b>Category</b>	<b>a</b>	<b>b</b>	<b>c</b>	<b>d.1</b>	<b>d.2</b>	<b>d.3</b>	<b>d.4</b>	<b>e</b>	<b>Total a-e</b>
1000 Taxes on income, profits & capital gains						63734			63734
2000 Social security contributions									
3000 Taxes on payroll and workforce									
4000 Taxes on property		4108							4108
5000 Taxes on goods and services	1991					2181			4172
6000 Other taxes	86								86
<b>Total</b>	2077	4108	0	0	0	65915	0	0	72100
(% distribution)	2,88%	5,70%	0,00%	0,00%	0,00%	91,42%	0,00%	0,00%	100,00%
	<b>1999</b>								
<b>Category</b>	<b>a</b>	<b>b</b>	<b>c</b>	<b>d.1</b>	<b>d.2</b>	<b>d.3</b>	<b>d.4</b>	<b>e</b>	<b>Total a-e</b>
1000 Taxes on income, profits & capital gains						67634			67634
2000 Social security contributions									
3000 Taxes on payroll and workforce									
4000 Taxes on property		4248							4248
5000 Taxes on goods and services	1936					1755			3691
6000 Other taxes	106								106
<b>Total</b>	2042	4248	0	0	0	69389	0	0	75679
(% distribution)	2,70%	5,61%	0,00%	0,00%	0,00%	91,69%	0,00%	0,00%	100,00%

Sources: Czech Ministry of Finance; The OECD Revenue Statistics 1965-1999; OECD Tax Policy Studies No. 1: Taxing Powers of State and Local Government

For a detailed description of the discretionary powers of municipalities and the character of local taxes, see Chapter 4.2 and the Annex.

### 3.1.2 Non-tax revenue

Table 3.1 shows the breakdown of municipal non-tax revenues. A substantial exemption in public revenue development represents a 1999/1998 increase in "other non-tax revenues" of 127 per cent, which is caused by the 185 per cent jump at the local government level. This development reflects extraordinary capital revenue. Municipalities sold their securities, mainly shares of companies supplying gas and electricity, and others. In 1999, total proceeds from sales of stocks were CZK29 billion (including CZK 25,360 million from distributing companies). This process has continued in 2000, although at a much lower level, so at present, this kind of asset is of marginal importance only. Municipalities preferred short-term expenditure "needs" to the long-term possibility of influencing the prices of energy. The breakdown of what the extraordinary 1999 revenue was used for is as follows:

**Table 3.9 The use of municipal financial sources from stocks sold in 1999, in millions of CZK**

Total revenue	1999 budget expenditure	credit repayments	long-term bank deposits	other deposits
25360	15639	1539	5933	2249

Source: Ministry of Finance of the Czech Republic (figures concern shares of distributing companies only)

The distribution of said non-tax revenue depends on the municipality population because the state originally distributed the shares of supply companies to municipalities according to the size of their population. So, the minimum municipal revenue was CZK 1,400, while the bigger towns received millions of CZK; the maximum reported revenue was CZK 528.2 million.

### 3.1.3 Inter-government financial relations – Grants

Grants to local governments are classified in the following Table.

**Table 3.4** The profile of central grants to local governments, 1997, 1998 and 1999, in millions of CZK

Year	Specific Grants			General Purpose Grant			Total
	Current			Objective criteria		Discretionary	
	Conditional		Not Conditional	Without	With		
	Standard Costs	Actual Costs		own tax effort	own tax effort		
1997	2862	9198	10261				22321
1998	3823	8738	10177				22738
1999	4060	9402	11848				25310

Source: Ministry of Finance of the Czech Republic

The "current" grants cover both capital and current (operating) grants. Capital grants represent about 40 per cent of the total amount; development is slightly declining – 43.6 per cent in 1997, 40.4 per cent in 1998 and 39.4 per cent in 1999. With regard to the development of non-conditional grants and conditional grants at actual costs, the decrease in 1998 was caused by a reduction in capital

grants. Local government receives grants from both the state budget and state funds; e.g. in 1999, State Environmental Fund granted municipalities a total amount of CZK 1,283 million.

### **3.2 Sub-national expenditure**

Table 3.6 shows general government expenditure, distributed by level of government. Data are consolidated. As far as the taxes paid by government are concerned, an adjustment is made, i.e. the expenditure data are proportionally adjusted for the employers' contributions paid by governments and for direct taxes paid by municipalities.

In the Czech Republic, the most important municipal policy sectors are (1) housing and community amenities, (2) transportation and communications, and (3) general public services. In Table 3.7, main expenditure and revenue indicators for said policy sectors are identified. For more details on municipal expenditures, see Chapter 4.1.



**Table 3.6** Current expenditure by function and level of government, 1997, 1998 and 1999, in millions of CZK

		Central Government and Social Security			Regional Government			Local Government			General Government (Consolidated)		
		1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
1	General public services	24251	26335	30230				18260	18181	19589	38493	40418	45680
2	Defence	26504	30286	33337				485	245	80	27049	30596	33502
3	Public order & safety	30513	31484	34303				3122	3142	3697	33367	34332	37661
4	Education	61899	60696	65597				13665	13884	14468	75518	74518	80006
5	Health	106538	116632	121366				1517	1388	1598	108281	118249	123224
6	Social Security & Welfare	217758	235387	252018				9198	11129	13541	227125	246651	265706
7	Housing & community amenities	17332	13894	13772				42098	42340	45924	58376	54720	58064
8	Recreational, cultural & religious affairs	6959	7135	8468				8725	9279	9934	15519	16237	18202
9	Fuel & energy	3106	3087	2852				21	16	53	3135	3110	2912
10	Agriculture, forestry, fishing & hunting	14123	15193	17852				866	969	956	14973	16139	18797
11	Mining, manufacturing & construction, except fuel & energy	1324	2270	2518				315	284	259	1637	2554	2779
12	Transportation & communication	30408	28032	33327				22607	25421	25685	52786	53193	58746
13	Other economic affairs	20596	36533	25054				735	790	907	21362	37372	25988
14	Other functions	15525	16636	14166				5158	5567	8320	19949	20529	19369
15	<b>Total current expenditure</b>	576836	623600	654860	0	0	0	126772	132635	145011	697570	748618	790636
16	Total current government expenditure.												
	% of GDP	34.57%	34.68%	35.66%	0.00%	0.00%	0.00%	7.60%	7.38%	7.90%	41.80%	41.63%	43.06%

Source: Ministry of Finance of the Czech Republic

**Table 3.7** Expenditure indicators by the three most important policy sectors. Local government, 1997, 1998 and 1999, in millions of CZK, and as a percentage

	Housing & community amenities			Transportation & communication			General public services		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Local expenditure (on policy sector), in millions of National Currency	42098	42340	45924	22607	25421	25685	18260	18181	19589
	%	%	%	%	%	%	%	%	%
Local expenditure (on policy sector) as a proportion of total local expenditure	33.2	31.9	31.7	17.8	19.2	17.7	14.4	13.7	13.5
Local expenditure as a proportion of total government expenditure on (policy sector)	72.1	77.4	79.1	42.8	47.8	43.7	47.4	45.0	42.9
Local and regional expenditure (all subnational expenditure on the policy sector in question) as a proportion of total government expenditure on (policy sector)	72.1	77.4	79.1	42.8	47.8	43.7	47.4	45.0	42.9
Proportion of local expenditure (on policy sector) covered by specific grants	15.5	13.1	13.1	9.8	4.4	2.4	12.5	15.8	13.3
Proportion of local expenditure (on policy sector) covered by non-tax revenues	25.5	27.5	37.5	27.2	30.2	42.2	26.4	26.6	37.5

Source: Ministry of Finance of the Czech Republic

## **4. EVALUATIONS ON SUB-NATIONAL AUTONOMY AND NATIONAL FISCAL CONSTRAINTS**

### **4.1 General presentations of the sub-national government system. Summary on government finance reform policies**

The basis of local self-government is set out in the Constitution. The former local councils were discontinued in 1990 when a new Act on Municipalities was adopted. The functions and duties of local government were re-organised in accordance with the new system. However, some local governments still perform duties which are no longer compulsory for them.

All local governments have their own independent executive bodies which carry out the administration in the areas assigned to this level of government. They also have their independent administration of financial affairs. They carry out all tasks related to the planning, budgeting, and collection of local fees and management of their funds and debt. Local governments also have their own independent administration of personnel services and they carry out local elections, though they do not have any discretion in organising these elections. Local government is responsible for community planning - there is assistance with district offices for small municipalities. Local government has considerable discretion in carrying out planning tasks, as long as overall guidelines for territorial planning are respected.

Every municipality represents a legal entity. Its responsibilities are divided between own responsibilities and delegated responsibilities. Own responsibilities include tasks in: education, social care, health care, culture, public safety, local police (voluntarily), cleanness of municipality, solid waste management, water supply and sewerage systems. Also belonging to this group are: municipal property management, the foundation of legal entities, municipal budget management, urban planning, approving the development programme and supervising its performance. Further municipal functions consist of electing and establishing municipal bodies, municipalities may issue municipal decrees and participate in municipal associations, including foreign ones.

The delegated responsibilities of local government include the performance of state administration, this primarily being in the field of: keeping the birth, marriage and death registers; building law; and physical planning law. To oversee environmental protection, local transport, statistics, water standards, sanitation etc. from the point of view of legal requirements also belongs to this group.

Not every municipality meets all the tasks included in delegated responsibilities. Out of the total number of municipalities (6,239) only 383 do so. These particular municipalities provide delegated functions for smaller units. It is based on inter-municipal agreements or on district office decrees. Municipal expenditure related to the delegated responsibilities provision is partly met by state budget grants.

**Table 4.1** Expenditure assignment - actual status of the legal framework

		Central Government	Regional Government	Local Government
1	General public services	XX		X
2	Defence	X		
3	Public order & safety	X		
4	Education	X		
5	Health	X		
6	Social Security & Welfare	X		
7	Housing & community amenities			X
8	Recreational, cultural & religious affairs	X		XX
9	Economic services	X		
10	Fuel & energy	X		
11	Agriculture, forestry, fishing & hunting	X		
12	Mining, manufacturing & construction, except fuel & energy	X		
13	Transportation & communication	XX		X
14	Other economic affairs	X		
15	Other functions	X		

Source: Ministry of Finance of the Czech Republic

Key: X indicates which level of government holds the main responsibility for each service,  
 XX indicates which level of government holds the main responsibility for the service when a substantial part of it is also carried out by another level of government

Defence is fully assigned to central government. Local government involvement represents only civil defence duties.

Public order and safety is shared between two levels of government, though the majority is assigned to central government. Municipalities may introduce local police with limited power only (checking parking places). Fire brigades are mainly organised and financed by central government, though the four biggest cities also have them. Voluntary fire brigades can be found in some municipalities. They operate under the local government budget but central government supports them with grants (for special fire vehicle renovation, and so on).

Education is a shared function between two levels of government. Local government is responsible for providing children from the age of 6 to 15 with compulsory education, not including teachers' wages and a fixed volume of school textbooks. It is also responsible for pre-school education under the same terms as for the nine-year compulsory education. Teachers are not employees of local government. Some big cities also run secondary schools, and some municipalities run special types of school – for mentally retarded children, which are generally the responsibility of central government. Some local governments provide vocational education facilities, such as music and painting schools, which are partly financed through fees. When a child up to 15 years of age from one municipality attends a school in another municipality, the municipality in which this child resides pays a proportion of the school running costs. The central government supports compulsory and pre-school education through a per-pupil grant, calculated as a percentage of the average operating costs of these schools. A small grant is also assigned to capital costs in the case of school building renovation, etc.

Health services and hospitals are financed through the health insurance system. The majority of hospitals are run by central government. Some cities also operate hospitals (mainly small ones). In these cases, they mainly support their activities through capital grants. Homes for abandoned children up to the age of 3 are also run by local government and supported by central government.

The substantial part of social services and welfare is financed by central government. All pensions, as well as unemployment and sickness benefits, and family and child allowances, make up the most

important part. The situation is different when looking at social services like homes for elderly, mentally and physically handicapped adults and children, homes for abandoned children (between the ages of 3 and 18), and social asylums. These are mostly run by local government and there are some central government grants involved. They are calculated as a per bed amount derived, as a percentage, from the average operating costs. Local government organises social assistance to people in need. It is regulated by law (the benefits level and eligibility criteria) but local government has some discretion in the administration of social assistance. Social assistance includes home-care for the elderly and disabled, and the provision of cash benefit supplements.

Local government is responsible for housing. Municipalities were transferred almost all housing facilities which were built by the state prior to 1990. They may privatise this housing stock under the terms which they set themselves. Municipalities have been doing so to a different extent - the decision on which part of the housing stock to keep, was up to them and the situation differs across the country. Flats in municipal houses were sold predominantly to the occupiers of the time. Prices of these transfers differed substantially. There is rent regulation in place. Central government sets the maximum increase in rent, each year. The regulation does not concern the newly built flats financed without central government assistance. A municipality may get a central government grant for new housing construction. Besides housing, local government is also responsible for the cleaning of public areas, park maintenance, public lightening, public cemetery maintenance, refuse collection and disposal operations and management, the water supply, the sewage system and sewage treatment plants, gas and electricity supplies, and the maintenance of local roads. Mainly private companies provide solid waste collection and management of landfills, although this is not a rule. Water supply and sewerage systems were privatised. During the privatisation, municipalities got shares in these companies. Whether a municipality provides these services directly or through a public or private company, is up to their discretion. The sewage has to meet minimum standards. The sewage system and refuse collection and disposal is usually financed by the rates. Water, electricity and gas supplies are provided either by municipality companies or by public/private companies (generally, all of these companies are profitable; the surplus of the enterprises owned by the municipality could be used as a municipal non-tax revenue). The state passed 34 per cent of shares in companies supplying gas and electricity in the country to municipalities. The rest is owned either by the state (National Property Fund) or by private bodies (domestic as well as foreign). Prices of water, gas and electricity supplies are still regulated by central government. The regulation reflects the actual costs, therefore prices differ across the country.

Within local government responsibilities in the area of cultural and recreational activities, municipalities run libraries, museums, zoos, galleries, theatres and exhibitions. There is a set of central government non-mandatory grants supporting these local activities. Quite a lot of local governments manage sports centres, playing fields, swimming baths and other recreational and tourist facilities.

As far as agriculture, forestry, fishing and hunting are concerned, the main part of financial aid to farmers is paid by the central government. The municipalities finance projects of local importance and regions will do it on the regional level.

With regard to mining, manufacturing and construction, the mining reduction programme covers the central government as well as subsidies for the construction of a nuclear power station. The local government gives special grants. The majority of transport and communication is the responsibility of central government. Central government is obliged to finance railways (a State Company), highways etc. The inner city transport in 16 cities is the exception. Municipalities contribute to local bus transport companies, which are private bodies. The local government has the responsibility for local routes.

‘Other economic affairs’ is made up of: export aid (which is ensured by central government), tourism (mainly financed by municipalities), and special economic programmes, or the expenditures of special institutions (geology, meteorology, antimonopoly), which are usually included in the central government budget.

‘Other functions’ aggregates all remaining functions: environmental policy, partly financed by local government; and research, labour security, bank revitalisation programmes, etc. which are financed by central government.

Apart from the above-mentioned own tasks of local government, there is also a set of functions which are carried out by local government as delegated or transferred functions. They include environmental protection overseas, construction permits, and birth, death and marriage registers. Statistics, water standards, sanitation etc., from the point of view of legal requirements, also belong to this group of local government functions.

#### 4.1.1 Regions under new legislation

Overall public sector reform is just beginning. It has several tasks, establishing regional level of self-government being one of the most important. It should, in some way, compensate for the prevailing fragmentation of municipalities. In The Constitution (Code No. 1/1993 Coll., sec. 99) the existence of regions (Superior Territorial Self-governed Units, to be exact) has been mentioned since 1993. The present public administration in the Czech Republic is considered to be really centralised. Many operational regional decisions are taken at the central level of government which, in this case, cannot concentrate on strategic or methodological activities. During the debate in the mid-90's, the number of regions varied from 2 to 75. Eurostat stated that 8 regions fulfilled the NUTS-2 definition. Finally, in 1997, the law distinguishing 14 regions was approved (Code No. 347/1997 Coll.). Table 4.3 (regions) describes each of them.

**Table 4.3** Basic characteristics of regions in the Czech Republic

Region	Extent In km <sup>2</sup>	Inhabitants*)	Number of districts	Number of municipalities*)	Regional GDP to EU**)	Rate of unemployment***)
Pražský	496	1,209,855	1, resp.15	1	123.5	3.5
Středočeský	11,014	1,103,738	12	1,147	50.4	7.5
Budešovský	10,056	626,867	7	623	59.3	6.7
Plzeňský	7,560	555,410	7	505	64.0	7.4
Karlovarský	3,315	305,086	3	131	55.0	9.0
Ústecký	5,335	825,074	7	353	57.5	15.9
Liberecký	3,163	428,974	4	216	54.6	7.8
Královéhradecký	4,757	553,827	5	448	57.8	7.5
Pardubický	4,519	510,072	4	451	51.5	9.0
Jihlavský	6,925	522,846	5	730	51.5	9.2
Brněnský	7,067	1,141,172	7	643	59.9	9.8
Zlínský	3,965	600,617	4	297	57.0	8.7
Olomoucký	5,139	645,804	5	392	53.4	12.4
Ostravský	5,555	1,289,002	6	297	60.6	14.9

Source: Journal OBEC & finance 3/99, March 1999; Vyvoj regionalních rozdílů v ČR 1994 – 1999 (The development of regional differences in the Czech Republic 1994 – 1999) published by The Czech Statistical Office 25<sup>th</sup> September 2000

Key: \*) 1999 data.  
 \*\*) The final data are only available for 1997. The average rate of GDP per capita corresponds to 64.6 per cent of EU 15.  
 \*\*\*) The rate of unemployment in 1999, when the average rate was 9.4 per cent

The law entered into force on 1st January, 2000. Officially, regions exist but they have neither power nor revenues. During the year 2000, essential legislation norms were approved:

Legal framework:

No. 250/2000 Coll., Budgetary Rules for Local Governments  
No. 248/2000 Coll., on Regional Development  
No. 243/2000 Coll., Tax Revenue Assignment  
No. 220/2000 Coll., on Changes Related to the Act on Property of the CR  
No. 219/2000 Coll., on Property of the Czech Republic  
No. 218/2000 Coll., Budgetary Rules  
No. 157/2000 Coll., on Transfers of Some Assets, Rights and Liabilities to Regions  
No. 147/2000 Coll., on District Offices  
No. 132/2000 Coll., on Changes Related to Regional Reform  
No. 131/2000 Coll., on Prague  
No. 130/2000 Coll., on Regional Elections  
No. 129/2000 Coll., on Regions  
No. 128/2000 Coll., on Municipalities  
No. 114/2000 Coll., an amendment to the Act on Property Transfers to Municipalities

Acts usually have 1st January, 2001 as the date on which they come into force.

The first draft on regions proposed nearly independent units. During the process of ratification, some essential changes were made. The elections in November 2000, concluded the 1st phase of the public administration reform – the reform of territorial administration. Regional government will operate from the beginning of 2001. Their financial terms and discretion will be provisional for the first two years, as they will be under the close control of central government (i.e. the ministry relevant to a given activity). In this period, they will be financed mainly by central government grants calculated according to the operating costs of transferred facilities (secondary schools, social care facilities, roads etc.) at the previous year's level. The law on regional self-government does not strictly define its responsibilities. The definition is broad – care of the territory as a whole, especially from the point of view of creating proper conditions for social care development, environmental protection, regional transport and communication, education and cultural activities, and public safety. Particular facilities for carrying out these tasks will be transferred later on, either from the state or from district offices, which are supposed to terminate at the end of 2002. During the period 2001-2002, the organisation as well as assets will be transferred, step by step, from the central to the regional level together with the relative amount from the state budget to the relevant regional budget.

In spite of being named as superior or higher levels of local government, regions and municipalities have to be treated as separate independent bodies. The hierarchy (regions as a more powerful level) can only be applied in cases stipulated by law.

Independent responsibilities have to be distinguished from transferred (or delegated) responsibilities. Central government is obliged to finance transferred responsibilities but no specific method has yet been created. The mechanism of transferring is derived from the number of inhabitants – because all citizens should have the same benefits regardless of the size of the municipality they live in.

If the region becomes the owner of a building, some investment is also expected, and more or less state-owned estates do not represent the highest quality of previous maintenance. It indicates additional regional expenditures and again a necessity for additional transfers.

#### **4.1.2 Districts under a new legislation**

Districts (73 + the 4 biggest cities) that currently combine some state functions with functions of the lower level of governments, should serve as a "bridge" between municipalities and regions during the subsequent two years. During the period 1997-1999, the profile of district expenditure was as follows.

**Table 4.4** Current expenditure of district offices, by function, 1997, 1998 and 1999, consolidated, in millions of CZK

		Districts offices		
		1997	1998	1999
1	General public services	5,589	5,805	6,301
2	Defence	255	242	174
3	Public order & safety	2,683	2,817	3,334
4	Education	4	1	0
5	Health	4,238	4,337	5,510
6	Social Security & Welfare	5,852	6,546	6,888
7	Housing & community amenities	572	379	354
8	Recreational, cultural & religious affairs	1,291	1,401	1,521
9	Fuel & energy	0	0	0
10	Agriculture, forestry, fishing & hunting	1,135	1,200	1,138
11	Mining, manufacturing & construction, except fuel & energy	0	0	0
12	Transportation & communication	1,215	1,639	2,011
13	Other economic affairs	80	83	138
14	Other functions	819	935	663
15	<b>Total current expenditure</b>	<b>23,733</b>	<b>25,385</b>	<b>28,032</b>
16	Total current government expenditure. % of GDP	1.42%	1.41%	1.53%

Source: Ministry of Finance of the Czech Republic

From 2001, all districts, as well as their contributory and budgetary organisations, will become a new chapter of the state budget (No. 380). According to the 2001 state budget, there are now 269 budgetary and 759 contributory organisations in different service sectors (culture, health, etc.). In comparison with previous years, total revenue and expenditure reflect some additional changes in responsibilities stipulated in law (see above). The largest are: the transfer of the amount of grants designated to municipalities from the General Treasury Administration, maintenance expenditure of Educational offices (they used to be a part of the Ministry of Education but from 2001 they become a section of the district office; in total, 1 667 employees are supposed to be devolved), expenditure related to fire brigades were, on the contrary, transferred to the Ministry of the Interior. As mentioned in the new Budgetary Rules, districts will not receive any tax revenue. After the transitional period, districts shall be abolished (after 31<sup>st</sup> December, 2002) and their responsibilities shall be split among the central, regional and local levels where about 180 "responsible municipalities" will ensure some services for other municipalities. The process is called the 2<sup>nd</sup> phase. The Ministry of the Interior co-ordinates all steps within this period.

#### **4.1.3 Municipalities under a new legislation**

The existing Act on Municipalities was approved in 1990. The prepared reform of regional administration but also real, daily experiences caused a new draft to be made. Generally, the new law determinates, with precision, the rights, powers and obligations of a municipality (there are more than 150 sections in comparison with 70 in the existing law). Apart from "technical and procedural" sections, i.e. signs, names of streets, citizenship, local referendums, there are also regulations on the deeper issues of split and coalition municipalities, and co-operation between municipalities. Under self-governance, municipalities should ensure social care (e.g. old age pensions, children's homes), housing, transport, education, cultural development, security, and environmental development.

A municipality shall draw up its budget annually, have its accounts approved by 31st January by an auditor or related district office, and draw up its closing account by 30th June the following year. It



shall also take care of its own property and use the property effectively. In the case of a non-payable transfer of property from the state level to a lower level, conditions limiting further use could be applied. Likewise, a local assembly of representatives decides whether to accept a bank credit, issue bonds, gage property, or accept a debt take-over. All decisions made by local assemblies of representatives must be supported by more than half of the representatives.

The Budgetary Rules for local government were enacted as a new form of legislation used at the municipal level. In comparison with the present law where both levels (central and local) are included in one Act (the Act on Budgetary Rules supplemented by the Municipal Law), there will be three separate legal sections: Budgetary Rules for the state budget and the central level, Budgetary Rules for local government, and a Tax Revenue Assignment for the local level. Other aspects of the government finance reform are commented on in Chapter 4.2.2 and referred to in Chapter 4.7.

## **4.2 Local discretion – tax administration and relation to central government**

### **4.2.1 Local taxation**

According to the Constitution of the Czech Republic, taxes can only be imposed in line with legal acts of Parliament (according to the principle "no taxation without central representation"). The discretionary power of local governments is regulated by central legislation. Central government bodies administer most of local taxes, including collection and revenue assignment. Only small – from a fiscal point of view – taxes and fees on specific goods and services are completely administered by local authorities. With reference to the OECD system of classification regarding own taxes of sub-national government (Table 3.2), local governments in the Czech Republic have very limited tax autonomy. Lack of local government discretion over tax rates, the tax base, the collection process and their share in the revenue would ordinarily make personal income tax on wages and salaries, personal income tax of unincorporated individuals, corporate income tax and levies on the withdrawal of land central government taxes. Only the fact that the proceeds of personal income taxes and levies on the withdrawal of land are distributed in the area in which they are collected, makes them close to own taxes of local government. The share of municipalities in the revenue from corporate income tax is also formally deemed to constitute local tax revenue under Czech legislation.

As far as the local fees reform and new tax sharing system are concerned (see above), the yield of proposed local taxes will form only a small fraction of total local government revenue. Local tax administration will be similar to the present local fee administration. There will be no national system of valuation or setting up of revenue benchmarks.

Local government taxes are introduced below by increasing the heading under the OECD classification of taxes; this approach corresponds to the structure of Tables 3.1 and 3.2. (For a detailed description of own taxes of local government, see the Appendix).

The rates and base of personal income tax on wages and salaries (imposed through withholding at source – heading 1110) are set by the central government that also collects the tax. The proceeds collected in the four largest cities (Praha, Ostrava, Brno, Plzen) are shared between the city (70 per cent) and the central government (30 per cent). The revenue of the tax collected in the other areas is shared between central government and local governments in the reverse proportion. As far as the local share (30 per cent) is concerned, a third accrues to the municipality where the withholding agent resides. The remaining two thirds is distributed – on the basis of the district population – among the municipalities within the boundaries of a given district, including the resident municipality. As a result, local governments receive more than 47 per cent of the shared tax proceeds. The split of revenues from personal income tax on wages and salaries is fixed in central government legislation.

The rates and base of personal income tax of the self-employed that have not incorporated their business (heading 1110) are determined by the central government. Central government collects the

tax and automatically transfers all revenue to municipalities depending on the residency of the taxpayer. Municipalities have been entitled to all the revenue from personal income tax since 1993.

Total revenue from corporate profit tax (excluding own profit tax of municipalities, see below) and withholding tax on interest and dividends paid to corporations – both under the heading 1210 – is split between municipalities (20 per cent) and central government (80 per cent). These shares are stipulated in central government legislation. The municipal share is distributed to municipalities on the basis of the national population. The central level of government sets the tax base and tax rates, collects the tax, and determines the ratios for sharing the tax with the municipalities.

Municipalities automatically retain all revenue from profit tax (heading 1210) on profits earned through their own commercial activities, provided that the tax has been properly declared in a tax return filed to the tax office (central level of government). Thus, the retained tax is formally "collected" by municipalities. The central level of government sets both the tax base and tax rate. Municipalities benefit from retained revenue.

Municipalities set the tax rates of property tax (heading 4100) within a bandwidth. Its upper and lower limits and the tax base are determined by central government law. Municipalities are only free to set the rates of tax on buildings and urban plots. The central government assesses and collects both taxes on land (including urban plots) and buildings and transfers the revenues to municipalities according to the location of the real property.

Municipalities may impose the following taxes on (the use of) goods and services, under the provisions of current central government legislation:

- Fees on entry tickets (heading 5126)
- Fees on recreational units, based on capacity (heading 5126)
- Resort and recreation fees on visitors (heading 5213)
- Dog fees (heading 5213)
- Motor vehicle entry fees (heading 5213)
- Fees on operated gambling machines (heading 5213, as from 1998)
- Tax on the use of public space (5220)

Municipalities are free to set tax rates respecting the upper limits indicated by central law. They are also free to define the tax base through exemptions and various reliefs. Municipalities collect taxes and exclusively benefit from the revenues.

As far as the frequency of facultative implementation of the above-mentioned local taxes on goods and services is concerned, circa 90 per cent of municipalities use their right and impose at least one tax. Based on current estimates, the order of the tax tools spread is as follows: dogs, use of public space, gambling machines, recreational capacity, visitor resorts, entry tickets and motor vehicle entry. In the small municipalities, the dogs, the entry tickets and the use of public space represent widespread tax subjects (however the last one is not applied in the smallest villages). In bigger municipalities, the common taxable scope covers dogs, gambling machines, visitor resorts, recreational capacity, use of public space and entry tickets.

Municipalities participate in the administration and collection of the fee on standard waste collection and treatment (heading 5213) but both the rate and base of the fee are set by central government legislation. There is no specific earmarking of fee proceeds. The revenue from the dangerous waste deposit fee is assigned to the central budget.

Municipalities set the tax rates of the air pollution fee (heading 5213) within a given bandwidth, with the upper and lower limits and tax base fixed by central law. Municipalities charge and collect fees on small polluters only, a "small" polluter being defined by central government law. The proceeds are generally earmarked for environmental purposes. Fees on "large" polluters are imposed and collected by central government.

The Czech Republic also imposes levies on the withdrawal of land from agriculture and forestry, reported in *Revenue Statistics* under headings 5220 and 5213 (in the case of temporary withdrawal). The tax rates and tax base are set by central government which also collects the tax. The proceeds collected in the municipality area are distributed between that municipality (40 per cent) and central government (60 per cent). The revenue split is fixed in central government legislation. There is no specific earmarking of the revenue shared by municipalities.

Municipalities impose and collect miscellaneous license and permit fees (heading 5220), under provisions of central legislation. The central government sets tax rates and defines the base of these fees. Municipalities exclusively benefit from the revenues.

**Table 4.5** Detailed breakdown of municipal tax revenue according to the OECD classification of own taxes of SCG, 1999 (in millions of CZK)

Category		a	b	c	d.1	d.2	d.3	d.4	e
Personal income tax of unincorp. Individuals	1110						16.908		
Personal income tax on wages and salaries	1110						31.924		
Previous PIT	1110						31		
Profit tax *)	1210						13.581		
Tax on own profit	1210						5.190		
Real property tax	4100		4.248						
Fees on entry tickets	5126	70							
Fees on recreat. Units	5126	67							
Resort/recreat. Fees	5213	211							
Dog fees	5213	182							
Motor vehicle fees	5213	31							
Fees on operated gambling machines	5213	659							
Waste deposit fee	5213						358		
Air pollution fee	5213						20		
Levies on withdrawal of land from forestry and agriculture	5213/20						181		
Tax on use of public space	5220	716							
Misc. Licence and permit fees	5220						1.196		
Other taxes **)	6000	106							
<b>Total</b>		<b>2.042</b>	<b>4.248</b>				<b>69.389</b>		
<i>(% distribution)</i>		<i>(2.7)</i>	<i>(5.6)</i>				<i>(91.7)</i>		

Source: Ministry of Finance of the Czech Republic

Key: \*) Includes corporate profit tax and withholding tax on interest and dividends paid to corporations.

\*\*) Includes both unidentifiable fees on goods and services, and unallocated previous taxes and local fees.

The availability of the most important revenue sources depends on many factors. Some factors, such as general sharing rules or concentration (and profitability) of businesses, are of an objective nature. Other factors have a subjective character: they only consist of formal changes of a taxpayer's permanent home address or of an employer's registered office. The figures of the four most important municipal tax revenue sources broken down into regions, are as follows:

**Table 4.6** Regional composition of tax revenue

	<b>1997</b>			
Region	PIT on wages	PIT of self-employed	CIT (excl. tax on own profit)	Real property tax
Prazsky	42.8%	29.3%	11.7%	7.2%
Stredocesky	5.1%	10.6%	10.7%	13.6%
Budejovicky	3.3%	5.4%	6.0%	7.6%
Plzensky	5.7%	4.0%	5.4%	5.8%
Karlovarsky	1.4%	2.6%	3.0%	2.5%
Ustecky	4.3%	5.4%	8.3%	8.4%
Liberecky	2.1%	4.3%	4.2%	3.4%
Kralovehradecky	2.9%	4.4%	5.4%	5.9%
Pardubicky	2.4%	3.9%	5.0%	5.7%
Jihlavsky	2.1%	3.3%	5.1%	6.0%
Brnensky	11.2%	9.2%	10.9%	12.0%
Zlinsky	2.9%	5.8%	5.8%	5.0%
Olomoucky	2.7%	4.3%	6.0%	7.1%
Ostravsky	11.1%	7.5%	12.5%	9.8%
The Czech Republic	100.0%	100.0%	100.0%	100.0%

	<b>1998</b>			
Region	PIT on wages	PIT of self-employed	CIT (excl. tax on own profit)	Real property tax
Prazsky	44.3%	29.40%	11.7%	7.5%
Stredocesky	5.1%	11.30%	10.7%	14.5%
Budejovicky	3.2%	5.40%	6.1%	7.8%
Plzensky	5.4%	3.90%	5.4%	5.9%
Karlovarsky	1.3%	2.40%	2.9%	2.5%
Ustecky	4.2%	5.10%	8.0%	8.3%
Liberecky	2.0%	4.40%	4.2%	3.4%
Kralovehradecky	2.8%	4.30%	5.4%	5.9%
Pardubicky	2.4%	4.10%	5.0%	5.6%
Jihlavsky	2.0%	3.30%	5.1%	6.1%
Brnensky	10.8%	8.60%	11.0%	11.6%
Zlinsky	2.9%	5.00%	5.6%	4.9%
Olomoucky	2.7%	4.70%	6.4%	7.2%
Ostravsky	10.9%	8.10%	12.5%	8.8%
The Czech Republic	100.0%	100.0%	100.0%	100.0%

	<b>1999</b>			
Region	PIT on wages	PIT of self-employed	CIT (excl. tax on own profit)	Real property tax
Prazsky	45.9%	29.1%	11.6%	7.7%
Stredocesky	5.1%	11.0%	10.6%	13.7%
Budejovicky	3.2%	5.4%	6.1%	7.6%
Plzensky	5.4%	4.3%	5.4%	5.8%
Karlovarsky	1.3%	2.3%	3.0%	2.5%
Ustecky	4.0%	5.2%	8.1%	8.6%
Liberecky	1.9%	4.5%	4.1%	3.3%
Kralovehradecky	2.7%	4.2%	5.4%	6.1%
Pardubicky	2.4%	3.9%	5.0%	5.4%
Jihlavsky	1.9%	3.9%	5.0%	6.0%
Brnensky	10.8%	8.6%	11.1%	12.1%
Zlinsky	2.6%	5.1%	5.8%	5.0%
Olomoucky	2.6%	4.7%	6.3%	7.2%
Ostravsky	10.2%	7.8%	12.5%	9.0%
The Czech Republic	100.0%	100.0%	100.0%	100.0%

*Source:* Ministry of Finance of the Czech Republic

With regard to fiscal stability, the proceeds from personal income tax of the self-employed tend to be volatile. For example, in the Chomutov district, aggregated municipal tax revenue fell by 20 per cent during 1997-1998, while it grew by 24 per cent over the next period 1999-1998. Such changes are common and make municipal finance vulnerable, especially in small municipalities because of the migration or random investment of only one entrepreneur. Having little discretion over the income tax base and rates, municipalities influence the location of employers' registered offices and the moving of the self-employed through grants to these taxpayers. In practice, such grants work as attractive tax reliefs.

The sharing rules imposed a flat distribution of corporate income tax – excluding tax on profits from municipal business activities – of CZK 1,320 per capita, in 1999. The per capita real property tax revenue varies between CZK 270 (Prague) and CZK 530 (the average for municipalities in the Stredocesky region). The minimum per head revenue from the personal income tax of the self-employed is CZK 1,030 (municipalities in the Ostravsky region), whereas the Prague maximum is CZK 4,070 (the Prague exclusive maximum is CZK 1,780 for municipalities in the Liberecky region). With regard to personal income tax on wages and salaries, it is more correct to adjust municipal revenue for extra-revenue for the four biggest cities, which perform district functions. So an average net municipal wage tax revenue varies from CZK 1,190 per head in the Jihlavsky region to CZK 5,190 per head in Prague (the Prague exclusive maximum is CZK 1,770 for municipalities in the Plzensky region).

#### **4.2.2 New tax revenue assignment**

New tax sharing is also introduced within the public sector reform. It aims at stabilising local government finances and introducing a fairer system. Basically, the shares of central and local governments on tax revenue will be maintained at the present level. Therefore, the increasing strain on the central government budget is not supposed to be solved through the accounts of local government. The core of this change is to replace today's territorial basis (sharing the district yield and assignment according to the taxpayer's permanent home) with sharing personal income tax and some other taxes on a national basis. The present tax sharing has led to growing disparities in per capita tax revenue in

municipalities, which is considered to be unjust as only state taxes are shared and the possible municipal contribution to the tax yield is therefore very limited. The common revenue volatility of small municipalities is resulting from the unpredictable intended changes of the permanent home address of self-employed taxpayers and the shifting of employers' registered offices.

The proposed local taxes are based on the transformation of existing local fees: the rate ceilings will be slightly higher compared to the current ones. The real property tax base will be closer to the open market value using methods of mass appraisal because the present building tax base, derived from figures fixed in the central legislation, implies a decline in the real tax proceeds over time. Even these steps will not insure more discretion for local government over its tax revenue, as new competence of municipalities in this field is expected to be negligible.

Tax revenues obtained by municipalities will be changed from 2001. The new law limits the relation between the revenue and the locality where the tax was levied, except in the case of real estate tax. Generally, all tax revenues will be centralised, multiplied by special coefficients focused on the number of inhabitants and then distributed back to the municipality's budget. The percentage share of tax revenues was changed with respect to the average amount of tax revenues that was calculated for each group based on 1998 and 1999 data. From 2001, municipalities will receive a share of:

- i. 20.59 per cent of total VAT revenues
- ii. 20.59 per cent of total corporate income tax revenue (excluding tax on own municipal business income)
- iii. 20.59 per cent of total revenue from personal income tax withheld on wages, salaries, interest and dividends paid to individuals
- iv. 14.413 per cent of total revenue from personal income tax on other sources of income (mainly income from unincorporated businesses)
- v. 30 per cent of personal income tax on other sources of income (see iv.) paid by persons with a permanent home in the relevant municipality

The municipal share (i. – iv.) is distributed to municipalities on the basis of population. The number of inhabitants is taken as the main indicator of tax revenues. Using special coefficients favoring the bigger municipalities (see Table below), a modified percentage share will be established for each municipality, based on the total number of inhabitants in the Czech Republic. The municipality then receives an amount corresponding to its modified share.

Let us suppose that total VAT revenue is 120 000 units, all municipalities together can get 24 708 units ( $120\,000 * 20.59\%$ ). A municipality has 45 000 inhabitants and its percentage share of total number of inhabitants is 0.43269 % ( $45\,000 / 10\,400\,000$ ). For the calculation of tax revenue, the exact percentage is modified to 0.35230 % ( $0.43269\% * 0.8142$ ). The municipality receives 87.0458 units ( $0.35230\% * 24\,708$ ) as its share of VAT.

**Table 4.7** Coefficients to adjust the number of inhabitants

Number of inhabitants	Coefficients
– 100	0.4213
101 – 200	0.5370
201 – 300	0.5630
301 – 1 500	0.5881
1 501 – 5 000	0.5977
5 001 – 10 000	0.6150
10 001 – 20 000	0.7016
20 001 – 30 000	0.7102
30 001 – 40 000	0.7449
40 001 – 50 000	0.8142
50 001 – 100 000	0.8488
100 001 – 150 000	1.0393
150 001 and more	1.6715
Prague	2.7611

The example mentioned above could be changed depending on the actual number of inhabitants (for each municipality, the relevant date is 1<sup>st</sup> January of the current year). The Ministry of Finance and the Czech Statistical Office, which are responsible for the setting of exact figures, issue a detailed decree establishing the exact percentage share for each municipality.

As a result of the new tax assignment, elasticity of tax revenue with respect to GDP received by the state budget and local budgets shall approximate each other.

Tax revenue to be assigned to regions is under discussion. During the year 2001, a special Act should be approved; the new arrangement of tax revenue assignment is expected to be effective from 1<sup>st</sup> January, 2002.

#### **4.3 National regulation of the framework for non-tax revenues**

There are no national limits on deficit financing of local governments. Deficit may be financed with tax as well as non-tax revenue, and by debt. The only exception is that some central government grant provisions (mainly one new grant on capital projects) includes as one of its criteria that a municipality deficit/operating revenue ratio must not exceed 15 per cent. Municipalities, when providing local services, are mandated to set the price according to their own decision. The exceptions are rents and water supplies – with regulated prices.

#### **4.4 National policies on design of grants systems**

There are no specific measures set up to avoid national budgetary pressures from local government. The obligatory grants (mainly operating ones) are calculated each year when preparing the central government budget. Capital grants to local government are provided according the approved central government budget (or its chapters). There is no equalisation grant involved in the system.

The objective behind the design of the grant system is to provide central government assistance for certain local government activities. Education, social care, delegated state administration functions, environmental protection and cultural activities are the main areas of this support.

All grants transferred to local governments are specific in the sense that their provision does allow local governments to allocate them according to their discretion. The precise use of these grants is defined by central government. If these grants are not spent in the given year or for the given purpose they must be returned. Municipalities have to make an annual statement for all central government grants.

The major part of grants to local governments is represented by operating grants (almost 60 per cent). Under the heading **current not conditional grants**, in Table 3.4, we classify those which are a contribution from central government to local activities. Grants for old age pensions, centres for the handicapped, social benefits (for citizens in need and the handicapped), primary and pre-primary schools, homes for abandoned children and delegated state administration tasks are those of main importance. The amount of these grants is set in the central government budget and it may or may not be corrected for inflation each year.

Other grants are distributed according to a specific legal framework and are decided individually during the reading of the state budget act. They are **conditional** in the sense that they require financial participation at a different rate from the receiving municipalities. Grants for the prevention of crime and drug addiction on a local tier, and the contribution towards an active policy of employment and the regeneration of villages, belong to this group.

Within **capital grants**, only grants for building homes for social care, if they compensate the primary owners in the restitution process, could be considered as **not conditional**. These grants do not require municipal co-financing as all costs are funded from the state budget.

Other capital grants are **conditional** on the terms of financial participation. A municipality, when receiving this grant, must finance a certain share of total costs. The municipal share is not fixed at the same level for all capital grants.

Only a minority of these grants is calculated at **standard costs**. These include grants for building flats for rent owned by municipalities, and building houses with community care services.

Remaining grants are calculated as a share, at **actual cost**. The share of grant on the actual cost is not exactly fixed, but does have a maximum limit. These grants are provided for the management of water supplies and environmental protection activities. Sewage systems, water supply and treatment plants, revitalisation of the countryside, introduction of gas pipelines, rural revival, building up industrial zones, equipment for fire brigades, the development of town surface public transport and the building and renewal of hospitals and schools are the most important examples of this sort of grant for municipalities.

Grants to local government are not only distributed from the state budget but also from extra-budgetary funds, especially from the State Environmental Fund. Those grants are provided for environmental improvement activities such as management of water supplies, designs for saving energy, introductions of gas pipelines and revitalisation of the countryside. The financing design consists of a combination of grant, loan, and the receiver's own financial participation.

The reform to overcome the lack of stable, transparent, well-documented and formula-based relations and procedures is something for the future.

#### 4.5 National control on borrowing

There is no ex-ante control on local borrowing in place, at present. Local governments may borrow any amount from any institution (even abroad), for any reason, at any terms of interest rate, maturity etc. Only the municipal bond issue (like any other bond issue) requires approval from the Commission for Securities. Legislation says that central government is not responsible for local debt. There has not been a case in which central government would be called upon to assist a municipality in financial



difficulty. One reason is that each local government is granted (by the tax sharing principle in place) a certain amount of money regardless of its activities. Any local loan is considered to be a "private" business between the municipality and the lender. There are no nation-wide criteria for evaluating the financial capacity for loans and there is no process of permission for adopting a debt. There are no special terms for local loans, municipalities are supposed to borrow at the best market rate as it is in their own interest.

Generally, the sources of deficit financing for Czech municipalities are: 1) commercial bank credits; 2) municipal bonds; 3) other sources, including soft loans provided by the State Environmental Fund, reimbursable financial assistance from the central budget, and loans from multilateral or bilateral institutions, but their amount compared to the total debt is rather small. The municipal reserve fund (i.e. savings from the past) is also used. Table 4.1 shows outstanding stock of municipal net debt.

**Table 4.2** Indebtedness of municipalities: local net debt, 1997, 1998 and 1999, in billions of CZK

	1997	1998	1999
Commercial Bank Credits	13.5	18.0	17.6
Municipal Bonds	13.2	11.9	10.9
Other Loans	7.7	9.1	11.5
Total Debts	34.4	39.0	40.0
Local Budget Balance	-7.4	-3.1	13.5

*Source:* Ministry of Finance of the Czech Republic

In addition to the above-mentioned municipal debt, there is an aggregated debt of voluntary associations of municipalities of CZK 0.5 billion. The Act on Municipalities allows regrouping of municipalities with the authorisation of central government (district office). Such an association represents a legal entity (there are currently circa 300 registered associations). Figures on differences in net debt broken down into municipalities according to their size are as follows:

**Table 4.8** Indebtedness of municipalities: breakdown, 1999, in thousands of CZK

Population size	Number of municipalities	Number of indebted municipalities	% distribution of indebted municipalities	% of indebted municipalities	Total population of municipality	Total debt of municipality	Per cent distribution of municipal debt	Debt per capita	Debt composition		
									Municipal bonds	Commercial bank credits	Other loans
	(1)	(2)	(3)	(4)=(2)/(1)	(5)	(6)	(7)	(8)=(6)/(5)	(9)	(10)	(11)
0 – 100	576	112	3.6	19.4	40 486	37 465	0.1	0.9		12 859	24 607
101-200	1160	325	10.5	28.0	171 811	256 511	0.6	1.5		102 290	154 221
201-300	883	311	10.1	35.2	215 672	375 948	0.9	1.7		181 696	194 252
301-1500	2783	1585	51.3	57.0	1 826 448	4 465 642	11.2	2.4		2 332 967	2 132 675
1501-5000	572	495	16.0	86.5	1 467 776	5 370 570	13.4	3.7	160 000	2 863 702	2 346 868
5001-10000	134	131	4.2	97.8	930 262	3 273 183	8.2	3.5		1 778 553	1 494 629
10001-20000	66	65	2.1	98.5	937 508	3 471 680	8.7	3.7	200 000	1 962 151	1 309 529
20001-30000	28	28	0.9	100.0	697 970	1 450 637	3.6	2.1		865 171	585 466
30001-40000	9	10	0.3	111.1	309 840	980 345	2.5	3.2		662 912	317 433
40001-50000	6	6	0.2	100.0	268 546	392 197	1.0	1.5		255 030	137 168
50001-100000	17	17	0.6	100.0	1 247 257	2 878 573	7.2	2.3	500 000	1 543 276	835 296
100001-150000	1	1	0.0	100.0	103 015	593 093	1.5	5.8		339 164	253 929
150001-500000	3	3	0.1	100.0	872 366	4 720 530	11.8	5.4	2 585 475	807 033	1 328 022
>500000	1	1	0.0	100.0	1 186 855	11 706 450	29.3	9.9	7 430 000	3 879 031	397 419
TOTAL	6239	3090	100.0	49.5	10 275 812	39 972 824	100.0	3.9	10 875 475	17 585 835	11 511 514

Source: Ministry of Finance of the Czech Republic

The new legislation has not changed attitudes towards local borrowing. Article No. 85 in the Act on Municipalities No. 128/2000 Coll. gives a municipal assembly the power to decide:

- to obtain and convey immovables
- to sign a credit or a loan contract, a liability take-over contract or a guarantee contract
- to pledge immovables
- to issue bonds.

Article No. 36 in the Act on Regions No.129/2000 Coll. gives the same rights to regional assemblies.

Usually, banks carry out a kind of "due diligence" before they grant a credit. There is not any explicit state guarantee for loans taken by municipalities, and banks should treat municipalities as ordinary clients. The Security Commission should approve the issue of municipal and regional bonds as it does in other cases. A real difficulty could appear in the case of over-debt because the present legislation (Act. No 328/1991 Coll., on bankruptcy, sec. 1a) cannot be applied to municipalities.

As already mentioned, from 2001, regions will also legally be allowed to take out loans but as collateral they can only use assets formerly approved by the central body. A representative of the central body (minister), as a former owner of a building, will, together with a representative of the regional body (Head of the regional office, assembly), sign a contract where special conditions concerning collateral, as well as other types of use, have to be mentioned.

A local government agency can only receive a loan following the approval described above. An agency is a legal body incorporated in the Business Register.

#### **4.6 Local discretion - expenditure**

There are no national mandates for arranging subnational services. There are no standards of local services, no targets for local capacity. There are no expenditure norms and standards, and no part of the budget is earmarked for specific activities except central government grants. The choice between own production of services and contracting out is up to each municipality. The recruitment of personnel is decided by each municipality. The payment of personnel is ruled by a law valid also for state administration personnel.

There are no special standards for the expenditure "needs" of municipalities or regions. Only the population size is used as a general indicator. The criterion for state budget grants or the co-financing of municipal expenditure "needs" is an adjusted population size (bigger municipalities are privileged as financial flows to smaller municipalities are reduced).

Municipalities in the Czech Republic got a large degree of independence at the beginning of the 90's and now it seems to be almost impossible to reduce it (there is no change proposed to overcome the prevailing small size of municipalities). This means that mainly local governments decide on the structure of expenditures, loans taken when no previous central government approval is required, the creation of financial funds, and "out-budget" activities. The municipality does not use public money for these activities (called supplementary economic activities) but acts as an enterprise and has to follow the Business Code and other relevant Acts.

#### **4.7 General budget co-operation with central government**

The local government budget is supposed to be prepared for a one-year period. Multi-year budgeting is only recommended for capital outlays or for a loan. Although the state budget is obliged, under the new

legislation, to prepare a medium-term outlook, local governments can decide whether or not they will prepare and respect it. There is no overall budget target for local governments set by general budget frames or specified by sectors or output targets. As there has been an improvement in the local budget balance, there is no fiscal constraint set by central government. Local government is limited in its expenditure policy by law and by specific grants only.

When new activities are assigned to local government, a proportionate increase in expenditure is reflected in the grant increase. The compensation is calculated by central government.

Only the local assembly approves the budget of local government. There is no ex-ante approval of any tier of central government.

Local governments report on budget development, on a monthly basis, to the Ministry of Finance. There is a standard form. The Ministry of Finance has consolidated as well as unconsolidated data. Quarterly reports are included in the report of central government budget implementation, which is discussed in Parliament.

Accounting principles are established by law, and budget accounts are standardised. Local government reports do not include explanations for any deviation from target (approved budget) or non-financial performance data. They are purely statistical in form.

Audits are required by law. They are carried out either by an audit firm (private), for a fee, or by the district office in the district in which the municipality is located (without fee). The latter case is far more frequent. The audit is limited to a check of the legality of budget operations; there is no control over their efficiency. Audit reports are transferred to municipalities and should be discussed in the local assembly. The publicity of this report is not required. These reports are not passed to any tier of government.

District offices may audit the self-governance decisions and notices issued ex-post, and mainly control compliance with the law. In the case of breach of law, they could, as a last resort, ask a regional court to arbitrate. District offices also survey the execution of transferred power. Ultimately, the Constitutional court could decide a possible conflict. Regions control decisions and notices in the three largest cities. The Act on Municipalities is not applicable in Prague because it is regulated by a special act.

The final version of the budget also includes subsidies received from the state budget and will, in the future, include subsidies from regional budgets.

## **ANNEX**

### **Description of current own taxes of sub-central government**

**(according to the Structures of the Tax Systems used in the EU, as of 1<sup>st</sup> January, 1999)**

#### **INCOME TAX**

##### **Legal base:**

Law No. 586/1992 Coll., latest amendments No. 209/1997, 210/1997, 111/1998, 149/1998, 168/1998, 227/1998, 333/1998, 129/1999, 144/1999, 163/1999, 170/1999 Coll.

The income tax code covers both individuals and companies; the computation of taxable income follows the same rules for both cases; the computation of the tax due and the rates, however, differ greatly; hence individual income tax and corporate income tax are here described as separate items.

#### **INCOME TAX OF INDIVIDUALS**

##### **Legal base:**

Law No. 586/1992 Coll., latest amendments No. 209/1997, 210/1997, 111/1998, 149/1998, 168/1998, 227/1998, 333/1998, 129/1999, 144/1999, 163/1999, 170/1999 Coll.

##### **Beneficiary:**

Law No. 576/1990 Coll., latest amendment No. 160/1997 Coll.

Central and local governments.

Tax payable by:

Residents on their world-wide income, non-residents on their Czech source income.

##### **Basis of assessment:**

Income from the different categories is aggregated to compute the taxable base with the exception of interest and dividends, where the flat rate withholding taxes are deductible against the final income tax liability.

##### **Categories of taxable income are:**

Income from present or former employment. Employee's social security contributions is deductible.

Income from business activities and independent services (agriculture, trade, other business, intellectual property rights etc.) and from leasing or rents. Expenses related to the activity are deductible, either in detail or as a lump sum deduction ranging from 20 % for rents income, 25 % for trade and business income to 30 % for income from intellectual property and to 50 % for income from agriculture.

Income from capital assets is treated like other income, with exception of interest and dividends, cf. first paragraph above.

**Exemptions:**

Tax exemption is granted for certain types of income like sale of a dwelling used as the tax-payer's home for at least 2 years, benefits from social insurance and most of the benefits from private insurance, scholarships etc.

**Deductions:**

The tax code defines deductible expenses by common rules for corporations and individuals. Donations for purposes of science, education, culture, medicine, ecology, sports, religion are deductible up to 10 % of the taxable base.

Losses may be carried forward for 7 years.

The basic personal allowance is CZK 34.920 for the taxpayer, additional CZK 19.884 for a spouse living in the taxpayers household and with an income of less than CZK 32.040, and an allowance of CZK 21.600 for each child living in the taxpayer's household.

**Collection:**

Tax on employed income is withheld by the employer. Other income is taxed according to the annual tax return; monthly, quarterly or twice a year advance payments are due depending on last years assessment.

**Rates:**

The following Table shows rates as of 1<sup>st</sup> January, 1999:

Taxable income (CZK)	Tax on lower amount	Plus % on excess over lower amount
Up to 102.000	-	15
102.000 to 204.000	15,300	20
204.000 to 312.000	35,700	25
312.000 to 1.104.000	62,700	32
Over 1.104.000	316,140	40

For dividends the rate is 25%. For interest from savings accounts the rate is 15%. For authors' royalties the rate is 10%.

**Special features:**

Tax revenue statistics for the Czech Republic display individual income tax in 3 categories

withholding tax on wages and salaries,

other income tax of unincorporated individuals,

taxes withheld on interest, dividends and other income paid to individuals.

**CORPORATE INCOME TAX****Legal base:**

Law No. 586/1992 Coll., latest amendments No. 209/1997, 210/1997, 111/1998, 149/1998, 168/1998, 227/1998, 333/1998, 129/1999, 144/1999, 163/1999, 170/1999 Coll.

**Beneficiary:**

Law No. 576/1990 Coll., latest amendment No. 160/1997 Coll.

Central and local governments

**Tax payable by:**

Income of all legal persons – public and private limited companies and other entities doing business – in short: companies – is subject to corporate income tax.

Remark: At public companies the determined tax base is divided among partners. If partners are represented by legal entities (corporations) it will be applied to them the same regime of taxation as to other legal entities. When partners are represented by natural persons, it will be applied to them the regime of taxation covering natural persons.

**Basis of assessment:**

Companies are taxed on their worldwide income. Taxable base is gross income minus expenses for obtaining this income as shown in the profit and loss account, capital gains are treated like other business income.

Distributed profits are taxed both on the company and on the shareholder level; to relieve double taxation a company may credit 50 % of the withholding tax on dividends paid out of profits against its corporate income tax liability.

Special deductions are allowed for special types of investments.

**Exemptions:**

Exempt is interest from securities secured by a mortgage and interest on Eurobonds issued by a resident company and paid out to non-residents.

**Deductions:**

Depreciation allowances for tangible and intangible assets with a useful life of more than 1 year are granted in five depreciation categories (4 years, 6 years, 12 years, 20 years and 30 years); there is a choice of linear or accelerated depreciation.

Reserves and provisions for bad debts are deductible under certain conditions.

There are different types of investment incentives

As of 1998 incentives for large scale investments meeting certain conditions (investment of at least USD 10 million in 5 years in the manufacturing industry, qualifying as high tech and as environmentally friendly); corporate income tax may be deferred for 5 years and waived if profits are reinvested in the Czech Republic after the first 5 years.

There is an investment allowance of 10, 15 or 20 % of taxable base for certain privileged investments.

Losses may be carried forward for 7 years, losses resulting from certain privileged investments indefinitely.

**Special features:**

Group treatment: In groups of companies each entity is taxed separately. Double taxation of intercorporate dividends is eased by partial deduction for already paid withholding taxes.

Transfer pricing rules: if prices for transactions between entities that are associated economically or personally differ from standard prices, the taxable base will be adjusted by the price difference.

**Collection:**

All payers of income tax are required to make prepayments at 6 months, 3 months or 1 months intervals depending on the amount of their latest tax liability.

**Rates:**

Profits and capital gains of legal entities are taxed at a flat rate of 35 %. The profits of investment and pension funds are taxed at 25 %.

Fees paid to members of the board of directors are taxed as wages with income tax of individuals.

**REAL PROPERTY TAX**

**Legal base:** Law No. 338/1992 Coll., latest amendment No. 248/1995 Coll.

**Beneficiary:** Law No. 576/1990 Coll., latest amendment No. 160/1997 Coll.

Local government

**Tax payable by:** Owner or beneficial owner of land and buildings.

**Basis of assessment:** Tax on land:

Agricultural and forestry land, ponds for intensive fishing is taxed on the basis of the purchase price.

The tax bases of agricultural land are average prices in the cadastre areas. These prices are derived from quality of soil according to valid price decree.

The tax base of commercial forests and ponds used for intensive fish farming are average prices according to valid price decree.

The tax base of built-up areas, developed land and other land is the actual area of the plot of land in square meters.

The taxable values are not adjusted to market prices in regular intervals, ad hoc amendments only.

Tax on buildings:

The tax is levied on buildings and structures submitted to building inspection.

The tax base is the area of the ground plan of the overhead part of structure in square meters.

**Exemptions:**

Tax on land:

Land owned by the state, by the municipality, by accredited diplomatic representatives.

Plots of land forming one functional unit with the building used for religious services of churches, public service companies, schools, museums, galleries, libraries, medical establishment, social care establishment, foundations or used for improvement of environment

Land used as parks and sport grounds for the public.

Agricultural land and woodland after recultivation.

Agricultural land for a period of 5 years and commercial forests (up to 10 years) restituted to owners.

Land determined for public transport

Land which is subject to the building tax, protective and special woodland, water areas except ponds for intensive fish farming, land used for defence of state.

Tax on buildings:



Buildings owned by the state, by the municipality, by accredited diplomatic representatives.

Buildings used for religious services of churches, public service companies, schools, museums, galleries, libraries, medical establishment, social care establishment, foundations or used for improvement of environment

Newly constructed houses for non-business for a period of 15 years,

Culture monuments for period of 8 years

Buildings used for public transport.

In certain cases is the building exempted from the building tax provided that it is not used for business activity or leased.

Dams, water supply systems, sewage systems, structures used to distribute energy, public roads.

#### **Rates:**

Tax on land:

The tax rate on arable land, hop-fields, vineyards, gardens and orchards is 0.75 % of the average price.

The tax rate on meadows and pastures, commercial forests and ponds used for intensive fish farming is 0.25 % of average price according to valid price decree.

The tax rate on built-up areas and courtyard, and other land is 0,1 CZK per square meter.

The tax rate on developed land is 1 CZK per square meter. This tax rate is multiplied by coefficients ranging from 0.3 % to 4.5 % according to the size of the municipality, local government has limited discretionary power to set this multiplier.

Tax on buildings:

dwelling houses: 1 CZK per square meter multiplied by the coefficient in the same way as in the case of developed land,

buildings for individual recreation purposes: 3 CZK per square meter

non residential area: 1 CZK per square meter,

garages built separately from dwelling houses: 4 CZK per square meter,

Structures for business purposes:

used for primary agricultural production, forestry or water management: 1 CZK per square meter of the built-up area,

used for industrial production civil construction, transport, power engineering: 5 CZK per square meter of the built-up area,

used for other business activities: 10 CZK per square meter of the built-up area ,

Other structures: 3 CZK per square meter of the built-up area

These rates are multiplied coefficients ranging from 0.3 % to 4.5 % according to the size of the municipality, local government has limited discretionary power to set this multiplier.

#### **FEES ON ENTRY TICKETS**

**Legal base:** Law No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Organiser of the action (cultural, sport, sales etc.)

**Basis of assessment:** Lump sum of admission fees

**Rates:** Maximum 20 %, set by local government

**Exemption:** Set by law (charity and similar actions) or by the local government.

#### **FEES ON RECREATIONAL UNITS (based on capacity)**

**Legal base:** Law No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Owner of accommodation capacity, collected only in spas and tourist regions.

**Basis of assessment:** Number of beds per day used for accommodation.

**Rates:** Maximum 2 CZK per bed/day, set by local government.

**Exemption:** Set by law (accommodation for students, for employees of owner of accommodation capacity, buildings of health or charity institutions) or by the local government.

#### **RESORT AND RECREATION FEES ON VISITORS**

**Legal base:** Law No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Natural persons, who are in spas or tourist regions on holidays or therapeutic stays

**Basis of assessment:** Number of days of stay

**Rates:** Maximum 15 CZK/day per person, set by local government

**Exemption:** Set by law (disabled persons, children aged up to 18 years, seniors aged above 70 years) and other special exemptions based on local government discretion.

#### **DOG FEES**

**Legal base:** Law of CNR No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Owner of the dog

**Rates:** Maximum 1000 CZK/year per dog, second and other dogs maximum 1500 CZK/year per dog, set by local government.

**Exemption:** Set by law (dogs of disabled persons) or by the local government.

#### **MOTOR VEHICLE ENTRY FEES**

**Legal base:** Law No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Person who has permission for entrance to selected places

**Basis of assessment:** Number of days which is the permission valid

**Rates:** Maximum 20 CZK/day, set by local government

**Exemption:** Set by law (person who have temporary stay at selected place and their relatives, disabled persons, persons who perform economical activity in real property at selected place) or by the local government

#### FEES ON OPERATED GAMBLING MACHINES

**Legal base:** Law of CNR No. 565/1990 Coll., latest amendments Act No. 305/1997 Coll. and Act No. 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Operator of the gambling machine

**Basis of assessment:** Time (in quarter of year) for which the gambling machine is operated

**Rates:** From 1000 CZK to 5000 CZK per 3 months (quarter of year), set by local government

**Exemption:** None

#### LEVY ON WITHDRAWAL OF LAND FROM FORESTRY

**Legal base:** Law No. 289/1995 Coll.

**Beneficiary:** Municipality (40%), State Environmental Fund (60%).

**Tax payable by:** Subject who asks for withdrawal of land which functions as a forest.

**Basis of assessment:** Area (ha) of withdrawn land.

**Rates:** Annual levy on temporary withdrawal =  $PP * CD * f$   
PP ... average forest production of timber (6,3m<sup>3</sup>/ha)  
CD ... price of timber in the area of withdrawal  
f ... environmental factor (1,4 to 5)

Lump sum levy on permanent withdrawal is equal to present value of perpetual annual levy on temporary withdrawal with interest rate of 2 % (i.e. 50 x annual levy on temporary withdrawal).

#### LEVY ON TEMP. WITHDRAWAL OF LAND FROM AGRICULTURE

**Legal base:** Law No. 334/1992 Coll., latest amendment Law No. 98/1999 Coll.

**Beneficiary:** Municipality (40 %), State Environmental Fund (60 %).

**Tax payable by:** Subject who asks for temporary withdrawal of land from the agriculture.

**Basis of assessment:** Area (ha) of withdrawn land.

**Rates:** Annual levy is calculated depending on ecological, climatic and other factors.

#### LEVY ON WITHDRAWAL OF LAND FROM AGRICULTURE

**Legal base:** Law No. 334/1992 Coll., latest amendment Law No. 98/1999 Coll.

**Beneficiary:** Municipality (40 %), State Environmental Fund (60 %).

**Tax payable by:** Subject who asks for permanent withdrawal of land from the agriculture.

**Basis of assessment:** Area (ha) of withdrawn land.

**Rates:** Lump sum levy is calculated depending on ecological, climatic and other factors (different from the levy above)

#### WASTE DEPOSIT FEE

**Legal base:** Law No. 125/1997 Coll., latest amendment Law No. 167/1998 Coll.

**Beneficiary:** The basic fee is attributed to the municipality. The risk surcharge is a revenue of State Environmental Fund.

**Tax payable by:** Producer of waste (according to this law municipalities are the producers of communal waste of natural persons non-entrepreneurs).

**Basis of assessment:** Amount (t) of waste

**Rates:** The rate schedule of the basic fee (CZK/t):

Year	1998	1999-2000	2001-2002	2003 and further
dangerous waste	200	250	350	450
communal and other waste	20	30	50	80

The rate of the risk surcharge (CZK/t):

Year	1998	1999-2000	2001-2002	2003 and further
dangerous waste	300	500	750	1000

#### AIR POLLUTION FEE

**Legal base:** Law No. 309/1991 Coll., latest amendment No. 158/1994 Coll.

Law No. 389/1991 Coll., latest amendment No. 86/1995 Coll.

**Beneficiary:** Either State Environmental Fund or local municipalities depending on the size of source of air pollution.

**Tax payable by:** The subject operating the source of air pollution. The subjects are divided into three groups:

- a) small – output power to 0,2 MW
- b) medium – output power above 0,2 to 5 MW
- c) large – output power above 5 MW

**Basis of assessment:** ad a) amount of kW of output power and the sort of fuel

ad b) and ad c) amount (t) and the sort of pollutant

**Rates:** ad a) annual fee is up to 40 000 CZK

ad b) and ad c) annual fee differs greatly, for example:

Polluting substance    Rate (CZK/t)

solid emissions    3 000

SO<sub>2</sub>    1 000

NO<sub>x</sub>    800

CO    600

hydrocarbons    2 000

**Exemption:** The person operating the small source (up to 50 kW) of air pollution not as business activity.

#### TAX ON USE OF PUBLIC SPACE

**Legal base:** Law No. 565/1990 Coll., latest amendments No. 305/1997, 149/1998 Coll.

**Beneficiary:** Local government

**Tax payable by:** Persons who use public space for specific reasons (to place facilities for providing services, sales or advertisement facilities, circuses, waste deposits, for permanent parking places, to perform sport events, to make movies etc.)

**Basis of assessment:** Square meters per day of used public space.

**Rates:** Maximum 10 CZK/day per m<sup>2</sup>, for sales or advertisement facilities, amusement facilities maximum 100 CZK/day per m<sup>2</sup>, set by local government

**Exemption:** Set by law (charity or public actions, assignment of permanent parking place for disabled person) or by the local government

#### MISCELLANEOUS LICENSE AND PERMIT FEES

**Legal base:** Law No. 368/1992 Coll.

**Beneficiary:** Either central government or local government (revenues are attributed to the administrator)

**Examples:** There are 154 areas of licences and fees, each area contains approximately 5 items (average).

Examples of fees administered by municipalities are:

Building licence, 300 – 3000 CZK,

Gambling machines permit licence, 30 000 CZK per year,

Permit of using roads and other local communications for specific purposes, 1000 CZK.